Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 96-45
Federal-State Joint Board on Universal Service	)	

ORDER ON RECONSIDERATION

Adopted: July 10, 1997 **Released: July 10, 1997**

By the Commission:

I. INTRODUCTION

1. On May 8, 1997, we adopted the Universal Service Report and Order (Order) implementing section 254 of the Communications Act of 1934, as amended (the Act).[1] Pursuant to section 1.108 of the Commission's rules,[2] we reconsider on our own motion several issues that we addressed in the Order.

2. With respect to schools and libraries, we conclude that an eligible school or library is not required to comply with the competitive bidding requirement for any contract for telecommunications services that it signs after November 8, 1996 and before the competitive bidding system is operational, but only if that contract covers only services provided to the school or library before December 31, 1998. We also conclude that an eligible school or library may not receive a federal universal service discount on services provided to it before January 1, 1998. In addition, we determine that the Commission will consult the members of the Federal-State Joint Board in CC Docket No. 96-45 (96-45 Joint Board) before adopting any changes to the discount matrix for schools and libraries.

3. We also make some adjustments to provisions of the Order concerning support

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[1] Federal-State Joint Board on Universal Service, *Report and Order*, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1997). The Commission released an erratum correcting this Order on June 4, 1997.

[2] 47 C.F.R. § 1.108. Section 1.108 of our rules states that the Commission may reconsider, on its own motion, "any action made or taken by it within 30 days from the date of public notice . . . ." *Id.* The date of public notice was June 17, 1997. 62 Fed. Reg. 32,862.

mechanisms for rural, insular and high cost areas. We redefine the method used to calculate the limit placed on the amount of corporate operations expense that may be recovered through the support mechanism for high loop costs. Because we find that the formula established in the Order may produce unintended results for some telecommunications carriers, we make the adjustments set forth below. In addition, we clarify that support for high loop costs will be administered and funded through the new universal service support mechanism that was established in the Order. We also reiterate that the Commission has not yet exercised its authority to assess universal service contributions from intrastate and interstate revenues and to require any carrier to seek state authority to recover a share of its contribution through intrastate rates. In addition, we restate that the Commission has committed to funding 25 percent of the necessary support for carriers serving high cost areas based on the federal-state partnership anticipated by the Act under which the Commission and the states together will fund the entirety of universal service support mechanisms. We also emphasize that section 254(k), which assigns the Commission, with respect to interstate rates, and the states, with respect to intrastate rates, separate roles in establishing measures to prevent subsidization of competitive services with universal service support, is properly addressed in orders released by the Commission and by individual state commissions, respectively, rather than in the Order.

4. Furthermore, we reiterate that upon a carrier's request the Commission will review decisions by state commissions not to waive the requirement that carriers not disconnect customers participating in the Lifeline program for non-payment of toll charges and will give great weight to the state commission's decision. Finally, we clarify that the Common Carrier Bureau (Bureau), in consultation with the 96-45 Joint Board, is to implement a new monitoring program and Monitoring Report based on information provided by the universal service administrator.

II. SCHOOL AND LIBRARY CONTRACTS

5. The Order required that, to be eligible to receive discounts for telecommunications services, Internet access, and internal connections, eligible schools and libraries had to comply with our competitive bidding requirement to select the provider of the desired services. We now clarify the extent to which schools and libraries that wish to, or may be compelled to, negotiate contracts for service during the period before the mechanisms needed to implement the Commission's competitive bidding requirement are ready must nonetheless comply with those bidding requirements. Because schools often negotiate their contracts for service during the summer months, we conclude that it is important to clarify these issues at this time so that schools will be able to negotiate contracts with full knowledge of the services that will be eligible for federal universal service support.

A. Existing Contracts

6. *Background.* In the Order, we concluded that eligible schools and libraries must solicit competitive bids for all services eligible for section 254(h) discounts.[3] We required a school or library to submit an application to the universal service administrator that includes a description of the services that a school or library seeks -- similar to a request for proposals -- and we required the administrator to post this information on a website.[4] These descriptions are to be available for all potential providers to review, thus facilitating schools' and libraries' ability to take full advantage of the competitive marketplace.[5]

7. We also held, however, that schools and libraries could obtain section 254(h) discounts without complying with the competitive bidding requirement for any contract signed before November 8, 1996, the date of the Recommended Decision.[6] In so doing, we adopted the 96-45 Joint Board's recommendation that the Commission not require schools or libraries to renegotiate existing contracts in order to benefit from federal universal service support.[7] We concluded that this decision was necessary to ensure schools and libraries affordable access to the services supported by the universal service program[8] and we concluded that schools and libraries had sufficient incentive to negotiate for low rates when they were paying the undiscounted contract price.[9] We also determined that it would not be in the public interest to penalize schools and libraries that have already signed long-term contracts for service by refusing to allow them to apply discounts to their existing contract rates.[10] We did not, however, authorize schools and libraries to obtain discounts on contracts signed between November 8, 1996 and the first date that the competitive bidding system becomes operational.

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[3] Order at paras. 479-80.

[4] *Id.* at para. 575.

[5] *Id.* at paras. 479, 575-79.

[6] *Id.* at para. 545; *see also* 47 C.F.R. § 54.511(c).

[7] *Id.* at para. 545-46; Federal-State Joint Board on Universal Service, *Recommended Decision*, CC Docket No. 96-45, 12 FCC Rcd 87, 377-78 (1996) (recommending that "the Commission not require any schools or libraries that had secured a low price on service to relinquish that rate simply to secure a slightly lower price produced by including a large amount of federal support").

[8] *Id.* at para. 546.

[9] *Id.* at para. 549.

[10] *Id.*

8. *Discussion.* We now conclude that we will make a limited extension of the competitive bidding exemption in order to accommodate schools and libraries that negotiate and sign contracts prior to the date that the competitive bidding system becomes fully operational.[11] We conclude that any contract signed after November 8, 1996 and before the first date that the competitive bidding system is operational will be considered an "existing contract" under section 54.511 of our rules, but only if the contract terminates no later than December 31, 1998. We adopt a definition of "existing contract" that includes this additional exemption.[12]

9. We extend the competitive bidding exemption because services obtained pursuant to a contract signed after November 8, 1996 and prior to the date that the competitive bidding system becomes operational would otherwise not be eligible for federal universal service discounts. We extend this exemption for the same reasons we adopted the existing competitive bidding exemption.[13] Specifically, we do not wish to penalize schools or libraries that seek to or must negotiate contracts prior to the date that the universal service competitive bidding system becomes fully operational. The competitive bidding requirement, however, is important because it implements the principle of competitive neutrality by allowing all providers access to information about particular schools' and libraries' needs and because it helps to ensure that schools and libraries will receive the lowest possible pre-discount price.[14] To ensure that schools, libraries, and service providers that qualify for this additional competitive bidding exemption do not negotiate long-term contracts during this interim period, and thus avoid the competitive bidding requirement altogether, we conclude that, in order to receive universal service discounts, contracts signed between November 8, 1996 and the date the competitive bidding system becomes operational must cover only services provided before December 31, 1998. We conclude that allowing the contract to govern service provided until December 1998 should give schools enough flexibility to procure service for the 1997-1998 school year and will allow schools and libraries to submit a single request for services for the entire 1998 funding year, but will also limit the set of contracts that are exempt from the competitive bidding requirement.

10. We conclude, as we did in the Order, that schools and libraries that invoke this exemption have sufficient incentive to negotiate low rates.[15] Although we acknowledge that,

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[11] We define the term "fully operational" in paragraph 11, *infra*.

[12] *See* Appendix A.

[13] *See supra* paragraph 7.

[14] *See* Order at paras. 479-82, 575-80. For a discussion of pre-discount prices, see *id.* at paras. 473-74.

[15] *Id.* at para. 549.

unlike schools and libraries that signed contracts prior to November 8, 1996, schools and libraries that sign contracts after that date were on notice that discounts might be available for the contracts they were negotiating. We find, however, that these entities continue to have an incentive to minimize their costs in obtaining service even if they receive section 254(h) discounts. Most important, they will pay a portion of the costs -- between ten percent and eighty percent -- of any contact price that they negotiate.[16] In addition, we note that many schools and libraries must comply with state or local government competitive procurement requirements.[17] Finally, our decision that contracts that benefit from this additional exemption may not cover services provided after December 31, 1998 will prevent schools, libraries, and providers from avoiding the competitive bidding requirement by signing contracts for extended periods of time. We find that this solution will assist schools and libraries signing contracts prior to the date the competitive bidding mechanism becomes available to obtain service for 1997-1998 school year without unduly diminishing the benefits of our competitive bidding requirement.

11. We will consider the competitive bidding system to be fully operational when both: 1) the Universal Service Administrator is ready to accept and post requests for service from schools and libraries on a website and 2) that website may be used by potential service providers. We will issue a public notice, which we will publish in the Federal Register, identifying the exact date that the competitive bidding system will be fully operational. Finally, we note that this limitation on the duration of a contract applies only to contracts signed after November 8, 1996 and before the date on which the competitive bidding system becomes fully operational. As we held in the Order, schools and libraries may sign multi-year contracts after the competitive bidding mechanisms is in place.[18] We do not impose here, nor did we impose in the Order, any durational limitations or competitive bidding requirements on contracts signed prior to November 8, 1996.[19]

B. Date Services Must Be Supplied

12. *Background.* In the Order, we determined that services provided pursuant to a contract signed prior to November 8, 1996 would be supported by the federal universal service mechanism if the expenditures were approved by the universal service administrator according to the established procedures. We also determined that "we should permit schools

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[16] *Id.*

[17] *See id.* at para. 493.

[18] *See, e.g., id.* at para. 544.

[19] *Id.* at paras. 545-49. Our reasoning is discussed *supra* paragraph 7.

and libraries to apply the relevant discounts to contracts that they negotiated prior to the Joint Board's Recommended Decision for services that will be delivered and used *after the effective date of our rules*."[20] We further held, "[n]o discount would apply . . . to charges for any usage of telecommunications or information services or installation or maintenance of internal connections prior to *the effective date of our rules*."[21] We also concluded that the universal service administrator should approve funding for services for each funding year, and that schools and libraries must reapply to the administrator on an annual basis.[22] In addition, consistent with the 96-45 Joint Board's recommendation, we adopted a cap on universal service support for eligible schools and libraries.[23] We adopted this cap in order to fulfill our statutory obligation to provide a specific, predictable, and sufficient funding mechanism despite the absence of historical data that would allow us to predict with precision the total cost of federal universal service support for schools and libraries.[24] We adopted an annual cap of $2.25 billion and determined that, during the initial six months of the program, between January 1, 1998 and June 30, 1998, no more than $1 billion could be collected.[25] We set the caps at these levels because, based on available data and the recommendation of the 96-45 Joint Board, we estimated that it would be sufficient to cover the total amount of funding necessary to support all eligible services for eligible schools and libraries.[26]

13. *Discussion.* We now find it necessary to adopt a rule to clarify that only services provided to schools and libraries after January 1, 1998 will be eligible for universal service discounts.[27] The Order stated that the funding year would be the calendar year, we adopted a funding cap based on the calendar year, we stated the support would begin to flow on January 1, 1998, and we required the universal service administrator to approve funding on

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[20] *Id.* at para. 545 (emphasis added). The Order was published in the Federal Register on June 17, 1997. 62 Fed. Reg. 32,862. According to the Administrative Procedure Act, 5 U.S.C. § 553(d), these rules therefore become effective 30 days after publication, on July 17, 1997.

[21] *Id.* (emphasis added).

[22] The rules for the administrator's approval of service contracts is discussed in detail in the Order at paras. 535-44.

[23] Order at para. 529.

[24] *Id.* at paras. 530-33.

[25] *Id.* at para. 529.

[26] *Id.* at paras. 530-34.

[27] This rule applies regardless of the date when the contract for these services was signed. *See* Appendix A.

an annual basis.[28] Nevertheless, we incorrectly stated in paragraph 545 that services supplied after the effective date of our rules would be supported.[29] The amount of funding reflected in the funding cap anticipates only the expected demand by schools and libraries for the six-month period between January 1, 1998 and June 30, 1998.[30] If all services supplied after the date our rules become effective were eligible for support, we would be attempting to support services supplied during the eleven and a half month period between July 17, 1997 and June 30, 1998 using funds that were estimated to be sufficient to support services supplied during the six month period between January 1, 1998 and June 30, 1998.

14. We conclude that this change will not impose a significant hardship on schools and libraries, particularly in light of our other holdings in the Order. As indicated above, other decisions in the Order are consistent with our intent and decision to provide funding to schools after January 1, 1998.[31] In addition, we determined that all schools and libraries must comply with the application process,[32] which will likely be completed by the first schools or libraries during mid-fall 1997, before being assured of receiving funding. In this context, we find it highly unlikely that any school or library relying upon our decisions in the Order would have made irrevocable decisions based on their anticipation that they would receive funding for services provided prior to January 1, 1998.

C. Modifications to the Discount Matrix

15. *Background.* In the Order, we concluded that, if it appears that funding requests by schools and libraries are likely to exceed the funding cap, we would consider lowering the guaranteed percentage discounts available to all schools and libraries for the next funding year by the uniform percentage necessary to permit all requests in the next funding year to be fully funded.[33] We determined that, after the universal service administrator estimated the appropriate adjustment for the discount matrix, the Commission would then approve any reduction in such guaranteed percentage discounts that it finds to be in the public

[28] *See* Order at paras. 535-38, 607.

[29] *Id.* at para. 545.

[30] *Id.* at para. 529.

[31] *See supra* text accompanying note 28, Order at paras. 535-38, 607.

[32] Order at paras. 545, 552-82.

[33] *Id.* at para. 542. We also concluded that we would not reduce the funding percentages for the two most disadvantaged categories. *Id.*

interest.[34]

16. *Discussion.* We now clarify that the Commission shall consult the members of the 96-45 Federal-State Joint Board before adopting any changes to the discount matrix, including those changes that might occur prior to the date we reconvene the 96-45 Joint Board.[35] We find that this approach will promote the joint federal-state cooperation we envisioned in the Order and will provide us with the benefits of states' experience and knowledge.

III. CORPORATE OPERATIONS EXPENSE

17. *Background.* In the Order, we concluded that the amount of corporate operations expenses that a carrier may recover through the existing high loop cost support mechanisms should be limited.[36] We established a per-line "range of reasonableness" that was defined for each study area as "including levels of reported corporate operations expense per line up to a maximum of 115 percent of the projected level of corporate operations expense per line."[37] We also concluded that the projected corporate operations expense per line for each service area should depend upon the number of access lines and should be calculated using a formula developed from the results of a statistical study, conducted by Commission staff, of data submitted by the National Exchange Carrier Association, Inc. (NECA), which represented the relationship between corporate operations expenses per line for a typical company and its number of access lines.[38] Specifically, we concluded that, for study areas with 10,000 or fewer loops, the formula defining the amount per line per month shall be $27.12 - (0.002 x the number of access lines).[39] For study areas with more than 10,000 lines, we determined that the amount per line per month shall be $7.12.[40]

18. Our analysis of the data for corporate operations expenses per access line

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[34] *Id.*

[35] We concluded that we would reconvene the 96-45 Federal-State Joint Board no later than January 1, 2001. *Id.* at para. 104.

[36] *See id.* at paras. 283-284.

[37] *Id.* at para. 284.

[38] *Id.* at para. 284, n.741.

[39] *Id.*

[40] *Id.*

suggests that these costs per line decline as access lines increase to 10,000, at which point these costs per line become approximately flat.[41] To this information we applied a regression technique that showed corporate operations expenses per line declining as the number of access lines increases for those companies with fewer than 10,000 access lines and remaining constant for companies with more than 10,000 lines.[42] We implemented a linear spline model[43] to force two line segments with different slopes to meet at the point of 10,000 lines.[44] Finally, we used the coefficients estimated by this regression to get the parameters in the formula.[45]

19. *Discussion.* We now reconsider on our own motion the formula we established to cap the amount of corporate operations expense that carriers can recover from high loop cost support mechanisms. There are two features of the formula that we believe warrant modification. First, under the existing formula, carriers with very small numbers of working loops might be unable to recover portions of corporate operations expense that are fixed or do not vary with the number of loops. This attribute occurs because, under the current formula, allowable corporate operations expense is determined by a factor that is multiplied by the number of loops. The second problem pertains to the relationship between the recoverable amount of support for corporate operation expenses produced by the formula and the number of working loops. Although, based on our analysis of data submitted by NECA, we expected that applying the formula would provide carriers with a total recoverable amount of support for corporate operating expenses that increases with the number of access lines or working loops,[46] we have determined that, within the range of 6,780 to 12,913 working loops, support for corporate operations expense does not increase with the number of working loops.[47]

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[41] *Id.*

[42] *Id.*

[43] A linear spline model is comprised of two lines that meet at a knot or inflection point.

[44] Order at n.741.

[45] *Id.*

[46] Pursuant to 47 C.R.F. § 36.611(a)(8), "working loops" are defined as "the number of working Exchange Line C&WF loops used jointly for exchange and message telecommunications service, including C&WF subscriber lines associated with pay telephones in C&WF Category 1, but excluding WATS closed end access and TWX access."

[47] For example, applying the formula to a carrier with 5,000 working loops would result in a cap of $98,440.00 of support for corporate operations expense [($27.12 - .002 x 5,000) x 1.15 x 5,000 = 98,440]. Under our provision for carriers with more than 10,000 working loops, however, a carrier with 11,000 working loops would receive no more than $90,060.00 [$7.12 x 1.15 x 11,000 = 90,060].

Accordingly, we make modifications to the formula set forth in section 36.621 of the Commission's rules for calculating the amount of support recoverable for carriers' corporate operating expenses. We set forth the methodology on which we base these modification in Appendix B.

20. Based on the conclusions set forth in Appendix B, we modify the existing formula as follows:

> for study areas with 6,000 or fewer working loops the amount per working loop shall be $27.12 - (0.002 x the number of working loops) or 1.15 x $8,266 / the number of working loops, whichever is greater;
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> for study areas with more than 6,000 but fewer than 17,988 working loops, the amount per working loop shall be $72,024 / the number of working loops + $3.12;
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> for study areas with 17,988 or more working loops, the amount per working loop shall be $7.12.[48]

We conclude that these modifications will result in total recoverable support amounts that increase proportionally with the number of working loops.[49]

21. The original formula also determined allowable corporate operating expense by multiplying the number of loops by a factor. This may have caused small firms to have difficulty recovering portions of corporate operations expense that are fixed or do not vary with the number of loops. It is necessary to modify the formula in order to allow carriers with small numbers of working loops to receive sufficient support to recover these initial or fixed corporate operations expenses. According to our analysis of data submitted by NECA, we estimate the minimum corporate operations expense per month to be $8,266.[50] Therefore,

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[48] The range from 6,000 to 17,988 is wider than the range identified as problematic in paragraph 14 (6,780 to 12,913). This extended range allows the formula to fit the available date more closely.

[49] By way of example, under these formulae, a carrier with 5,000 working loops could recover a total of $98,440.00 for corporate operations expenses [($27.12 - (0.002 x 5,000)) x 1.15 x 5,000 = 98,440] and a carrier with 11,000 working loops could recover $122,295.60 [($72,024 / 11,000 + 3.12) x 1.15 x 11,000 = $122,295.60].

[50] Using a sample of stand-alone companies with fewer than 2,000 working loops, total operating expense was regressed on working loops. The minimum total operating expense was estimated as the y intercept from the linear regression.

we are revising the formula appearing in the Order to ensure that no carrier recovers less than 1.15 x $8,266 ($9,505.90). The revised formula for maximum allowable support for monthly corporate operations expense per loop will be 1.15 x $8,266 divided by the number of working loops *or* the result of the formula for study areas with 6,000 or fewer working loops set forth in section 36.621, whichever is greater.

22. We find that these adjustments lead to results that are consistent with both the policies and intended outcomes enunciated in the Order. These modifications do not reduce the amount of corporate operations expenses carriers can recover through the support mechanisms for high loop costs. The new formulae continue to reflect our recognition that small study areas may experience greater amounts of corporate operations expense per working loop than large study areas. As stated above, we seek by this Order merely to eliminate outcomes that would result in carriers with fewer working loops receiving a total support amount that is greater than that of carriers with more working loops.

IV. FUNDING FOR THE HIGH COST LOOP SUPPORT MECHANISM

23. *Background.* The Order created a new federal universal service system governed by section 254 of the 1996 Act by converting the existing federal universal service support in the interstate high cost loop fund,[51] the dial equipment minutes (DEM) weighting,[52] Long Term Support (LTS),[53] Lifeline,[54] and Link Up[55] programs to explicit support mechanisms and establishing new support mechanisms for eligible schools, libraries, and health care providers.[56] Thus, the federal universal service system established in the Order now includes support for rural, insular, and high cost areas, low-income consumers, health care providers, schools, and libraries.[57] In addition, the rules and regulations concerning the administration and funding of all the universal service support mechanisms established in the

[51] *See* 47 C.F.R. § 36.601 *et. seq.*,Universal Service Fund. Prior to the issuance of the Order, the Universal Service Fund referred solely to the high cost loop support mechanism.

[52] 47 C.F.R. § 36.125(b).

[53] 47 C.F.R. §§ 69.105, 69.502, 69.603(e), 69.612.

[54] *See* 47 C.F.R. §§ 69.104(j), 69.117.

[55] 47 C.F.R. § 36.701 *et. seq.*

[56] Order at para. 6.

[57] *Id.* at para. 20.

Order are contained in Part 54 of our rules.[58]

24. *Discussion.* We clarify that, although the rules that describe the high loop cost support mechanisms and govern separations between the interstate and intrastate jurisdictions remain in Part 36, the expense adjustment for high cost loops, like the support for DEM weighting, LTS, Lifeline, Linkup, and Internet access for schools and libraries, will be administered and funded through Part 54 of our rules. We make this clarification because we find that the Order did not articulate that the expense adjustment calculated pursuant to Part 36 would be administered and funded through the new universal service mechanism set forth in Part 54.

V. UNIVERSAL SERVICE SUPPORT MECHANISMS

A. Commission Jurisdiction Over Universal Service Support Mechanisms

25. *Background.* In the Order, the Commission concluded that it has authority to assess contributions for the universal service support mechanisms based upon intrastate as well as interstate revenues and to require carriers to seek state (and not federal) authority to recover some share of its contribution through intrastate revenues.[59] The Commission reached this conclusion because the Act mandates the establishment of support mechanisms that are "sufficient" to "preserve and advance universal service."[60] This obligation necessarily falls upon the Commission because the statute limits the states' authority in this regard to adopting support mechanisms that do not conflict with federal mechanisms.[61] Notwithstanding this conclusion, the Commission expressly declined to exercise its full powers in the Order.[62] Above all, the Commission envisioned continuing its historical partnership with the states in preserving and advancing universal service mechanisms.[63]

26. *Discussion.* We take this opportunity to reiterate that, although the Order concluded that the Commission has authority to assess universal service contributions from intrastate and interstate revenues and to require carriers to recover some share of the

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[58] 47 C.F.R. § 54.1 *et. seq.*, Universal Service.

[59] Order at para. 813-823.

[60] *Id.* at para. 815 *citing* 47 U.S.C. § 254(d).

[61] 47 U.S.C. § 254(f).

[62] Order at paras. 813, 817-818, 822.

[63] *Id.* at para. 818.

contribution from intrastate revenues, the Commission has not exercised this authority. Recently, the Commission's Office of General Counsel (OGC) responded to an inquiry by clarifying that the Commission has not yet "crystallized its position regarding the proper treatment of the recovery of intrastate revenues and in any event has not required carriers to seek a portion of the contribution in intrastate rates."[64] Accordingly, the OGC concluded that any judicial challenge to paragraphs 813 through 823 of the Order would not be "ripe" at this time.[65] Because of the importance of this issue and the possibility that other interested parties have similar concerns, we take this opportunity to reiterate that, although the Act empowers it to do so, the Commission has neither assessed universal service contributions from intrastate and interstate revenues nor required carriers to recover some share of the contribution from intrastate revenues. For these reasons, any challenges to the Commission's authority are not currently ripe. The Order anticipated that the Joint Board would continue to consult with the Commission regarding the sufficiency of universal service support mechanisms[66] and we recognize that this issue is of primary concern to the Joint Board.

B. Assessment of the Revenue Base for the High Cost and Low-Income Support Mechanisms

27. *Background.* To promote comity between federal and state commissions, the Commission determined that, beginning January 1, 1999, federal high cost support mechanisms will fund 25 percent of the difference between the cost of service, defined as the difference between the applicable forward-looking economic cost mechanism and the national benchmark, through a percentage contribution levied on interstate end-user telecommunications service providers.[67] The Order recognized that 25 percent is the current interstate allocation factor applied to loop costs in the Part 36 separations process, and concluded that because loop costs will be the predominant cost that varies between high cost and non-high cost areas, this factor best approximates the interstate portion of universal service costs.[68] In adopting this approach, the Commission anticipated that states will participate fully in a federal-state partnership and that the contributions collected by both

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[64] *See* Letter from William E. Kennard, General Counsel, FCC, to Lawrence G. Malone, General Counsel, New York State Dep't of Public Service, dated June 13, 1997.

[65] *Id.*

[66] *See* Order at para. 271.

[67] *Id.* at para. 833.

[68] *Id.* at para. 269.

jurisdictions will be sufficient to fund universal service.[69] The Order envisioned that the Commission would, in the future, assess whether additional federal support is necessary to ensure that quality services remain "available at just, reasonable, and affordable rates."[70]

28. *Discussion.* The Order anticipated that states would take steps similar to those taken by the Commission in the Order to convert implicit intrastate support mechanisms into explicit support mechanisms.[71] As discussed in the Order, the 25 percent allocation factor for loop costs is historically applied to the interstate jurisdiction.[72] By funding 25 percent of the cost of universal service through federal support mechanisms beginning January 1, 1999, we sought to coordinate this approach with the shift of universal service support for rural, insular, and high cost areas served by non-rural LECs from the access charge regime to the new section 254 universal service support mechanisms.[73] We recognize that prior to that date, the costs of universal service will be carefully considered by the Commission, which will establish a forward-looking economic cost mechanism, and by the states, which may conduct their own forward-looking economic cost studies.[74] Accordingly, it is premature for us to reexamine our decision to fund 25 percent of universal service at this time. Our action today, does not, however, foreclose the possibility that, as states replace their programs with explicit support mechanisms, the Commission will reassess whether there is a need for additional federal support. Instead, we stress the need for federal-state partnership in order to allay any concerns that support amounts will be insufficient. Because it is critical to the preservation and advancement of universal service, we anticipate that this issue will be an important subject in future consultations between the Commission and the Joint Board.

C. Preventing Subsidization of Competitive Services

29. *Background.* Section 254(k) states that "[t]he Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services

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[69] *Id.* at para. 831.

[70] *Id.* at para. 834 *citing* 47 U.S.C. § 254(b)(1).

[71] *Id.* at para. 834.

[72] *Id.* at para. 270.

[73] *See id.* at para. 833.

[74] *See id.* at para. 247-249. States should elect by August 15, 1997 whether they will conduct their own forward-looking economic cost studies and those that elect to do so must file the cost studies with the Commission on or before February 6, 1998. *Id.* at para. 248.

included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."

30. *Discussion.* We clarify that, because section 254(k) assigns the duty of preventing the subsidization of competitive services to the Commission, with respect to interstate services, and to the states, with respect to intrastate services, the Commission did not discuss section 254(k) in the Order. Instead, in a separate order, the Commission adopted the statutory language, which will serve as the basis for Commission action with respect to the establishment of "cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common cost of facilities used to provide those services" for interstate services.[75] We expect that each state will also take action to implement safeguards for intrastate services.

VI. REVIEW PROCESS FOR CARRIER PETITIONS FOR WAIVERS

31. *Background.* The Order adopted a rule prohibiting carriers from disconnecting customers who participate in the Lifeline program for non-payment of toll charges.[76] The Commission concluded, however, that state utilities regulators will consider carriers' requests for waivers from the no-disconnect rule[77] and set forth a three-pronged test that carriers must meet in order to receive a waiver.[78] In addition, the Order provided that carriers may appeal to the Commission a state commission's denial of a waiver request. The Order also authorized carriers to file an appeal with the Commission if a state commission has not acted upon a waiver request within 30 days of its submission.[79] The Order requests that a state commission that chooses not to act on waiver requests should refer any such requests to the Commission.[80]

32. *Discussion.* We reiterate that carriers disagreeing with state commission decisions regarding a request to waive the no-disconnect rule may pursue their concerns with

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[75] *Implementation of 254(k) of the Communications Act of 1934, as amended*, FCC 97-163 (rel. May 8, 1997).

[76] Order at paras. 390-397.

[77] *Id.* at para. 396.

[78] *Id.*

[79] *Id.* at para. 396.

[80] *Id.*

the Commission. This approach will offer such carriers an additional forum for resolving their concerns. Nevertheless, in considering a carrier's arguments on the merits, the Commission will give great weight to a state commission's articulated rationales for denying a waiver request.

VII. MONITORING REPORTS

33. *Background.* In the Order, the Commission directed the administrator of the universal service support mechanisms to maintain and report to the Commission detailed records relating to payments made and received through the support mechanisms.[81] The Commission stated that the information contained in those reports would be made public at least once a year as part of a Monitoring Report and delegated to the Bureau the responsibility of creating and issuing the Monitoring Report. The Commission added that the Bureau should work with the state staffs of the Joint Boards in CC Dockets 96-45 and CC Docket 80-286 to implement the new monitoring program.

34. *Discussion.* We now reconsider on our own motion a limited aspect of that decision and clarify that the Bureau shall consult with the state staff of the 96-45 Joint Board to implement the new monitoring program. Because the Monitoring Report will be based on information regarding the universal service support mechanisms, we find that participation by the 96-45 Joint Board will ensure that the Bureau will have full access to the expertise of state staff. Because of its experience in implementing section 254, we find that the 96-45 Joint Board is fully able to help implement a monitoring program for the new universal service support mechanisms without drawing on the resources of the 80-286 Joint Board. We also clarify that, until the permanent administrator is chosen by a Federal Advisory Committee, the temporary administrator of the support mechanisms shall maintain and report to the Commission detailed records relating to the determination and amount of payments made and monies received through the support mechanisms which shall be used in the preparation of the Monitoring Report.

VIII. FINAL REGULATORY FLEXIBILITY ANALYSIS

35. In the Order, we conducted a Final Regulatory Flexibility Analysis, as required by section 603 of the Regulatory Flexibility Act, as amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996).[82] The changes we adopt in this Order do not affect that analysis.

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[81] *Id.* at para. 869.

[82] *Id.* at paras. 870-983.

IX. ORDERING CLAUSES

36. Accordingly, IT IS ORDERED that pursuant to authority contained in sections 1-4, 205, 221(c), 254, 403, and 410 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 205, 221(c), 254, 403, and 410, and pursuant to § 1.108 of the Commission's rules, 47 C.F.R. § 1.108, the Commission reconsiders its decision in the Order on its own motion to the extent specified herein.

37. IT IS FURTHER ORDERED that Part 36 and Part 54 of the Commission's rules, 47 C.F.R. §§ 36, 54, ARE AMENDED as set forth in Appendix A attached hereto.

38. IT IS FURTHER ORDERED that, pursuant to section 553(d)(1) of the Administrative Procedure Act, 5 U.S.C. § 553(d)(1), the amendments to 47 C.F.R. § 54.500 will take effect upon publication in the Federal Register or on July 17, 1997 (the date the Order will become effective), whichever is later. Because these amendments extend the competitive bidding exemption to accommodate schools and libraries prior to the date that the competitive bidding system becomes fully operational they are agency regulations that "grant[] or recognize[] an exemption or relieve[] a restriction."[83] Thus, pursuant to 5 U.S.C. § 553(d)(1), these amendments may take effect immediately upon publication in the Federal Register.

39. IT IS FURTHER ORDERED that all other policies and rules adopted herein shall be effective 30 days after publication in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

[83] 5 U.S.C. § 553(d)(1).

APPENDIX A - Amendments to Rules

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

PART 36 -- JURISDICTIONAL SEPARATIONS PROCEDURES: STANDARD PROCEDURES FOR SEPARATING TELECOMMUNICATIONS PROPERTY COSTS, REVENUES, EXPENSES, TAXES AND RESERVES FOR TELECOMMUNICATIONS COMPANIES.

1. Paragraph (a) is amended by adding the following sentence at the end of the paragraph:

§ 36.601 General.

(a) * * * Beginning January 1, 1998, the expense adjustment calculated pursuant to this subpart will be administered and funded through the new universal service system discussed in Part 54.

2. Paragraph (a)(4)(A) and (B) are revised and (a)(4)(C) is added to read as follows:

§ 36.621 Study area total unseparated loop cost.

(a)(4) * * *

(A) For study areas with 6,000 or fewer working loops; [$27.12 minus (0.002 times the number of working loops) times 1.15] or [1.15 x $8,266 divided by the number of working loops], whichever is greater.

(B) For study areas with more than 6,000 but fewer than 17,988 working loops; [($72,024 divided by the number of working loops) + $3.12)] times 1.15.

(C) For study areas with 17,988 or more working loops; $7.12 times 1.15, which equals $8.19.

PART 54 -- UNIVERSAL SERVICE

3. Part 54 of Title 47 of the Code of Federal Regulations (CFR) is amended by adding new § 54.500(a)(2), and renumbering § 54.500(a)(2)-(8) as § 54.500(a)(3)-(9) as indicated:

§ 54.500 Terms and Definitions.

(a) * * *

(2) Existing contract. For the purpose of section 54.511(c), an "existing contract" is any signed contract for services eligible for discounts pursuant to this subpart between an eligible school or library as defined under § 54.501 and a service provider that either:

(i) was signed prior to November 8, 1996, or

(ii) is limited to services provided before December 31, 1998 and was signed on or after November 8, 1996 but before the first date that the universal service competitive bidding system described in § 54.504 is operational. The competitive bidding system will be deemed to be operational when both the universal service administrator is ready to accept and post requests for service from schools and libraries on a website and that website may be used by potential service providers.

(3) Library. * * *

4. Section 54.507 is amended to add new § 54.507(f) and § 54.507(f) is relettered § 54.507(g) as indicated:

§ 54.507 Cap.

* * *

(f) Date services must be supplied. The administrator shall not approve funding for service received by a school or library before January 1, 1998.

(g) Rules of Priority. * * *

APPENDIX B - Explanation of Methodology for Modifications to Corporate Operations Expense Formulae

1. This appendix describes the procedure used to derive the formulae, set forth in section 36.621, for determining the allowable amount of corporate operations expenditures recoverable through universal service support mechanisms.

Selecting the Basic Model

2. In order to determine the best formula, we applied a statistical analysis to a number of different models that compared the relationship between corporate operations expense per loop and the number of loops using data supplied by NECA.[1] We used statistical regression techniques that focused on the relationship between expenses per loop, rather than total expense, in order to find a model under which the cap on corporate operations expense per line declines as the number of loops increases for a range of smaller companies so that economies of scale, which are evident in the data, can be reflected in the model. Of the models studied, the linear spline was found to have the highest R^2, a measure indicating that this model provides the best fit with the data. The linear spline model in this case is two line segments joined together at a single point or knot. In general, the linear spline model allows the cap on corporate operations expense to decline as the number of loops increases for the smaller companies having fewer loops than the knot point. Estimates of the linear spline model suggest that the cap on corporate operations expense per loop for companies with a number of loops higher than the spline knot is constant.

3. Choosing the spline model also required selecting a knot, the point at which the two line segments of differing slopes meet. We had two primary objectives in selecting the knot point. First, the model had to characterize accurately the relationship between corporate operations expense per loop and the number of working loops. Second, the model had to characterize accurately the relationship between total corporate operations expense and the number of working loops. To achieve these objectives, we examined the R^2s for both total corporate operations expense and corporate operations expense per loop over a wide range of knot points. The highest R^2 for per loop corporate operations expense was obtained for a knot point at 3800. We found, however, that the highest R^2 that reflects goodness of fit for the total corporate operations expense using the estimated model was obtained at 13,408 working loops. Visual inspection of the data representing corporate operations cost per loop

[1] Outliers were removed from the sample before estimation. These outliers were those companies whose corporate operations expense exceeded the mean of the sample by 3 times the sample standard deviation. The companies excluded from the sample had corporate operations expense exceeding $60.00 per loop. Also, two companies which reported negative corporate operations expense were removed from the sample.

indicates that cost per loop appears to flatten close to 10,000 loops.[2] At 10,000 loops, both R^2s remain near the maximum R^2s obtained for both per loop and total corporate operations expense. Accordingly, we selected 10,000 loops as the knot point that best meets both objectives.

4. The regression results, which incorporate a spline model that uses data provided by NECA, are as follows:

- for companies having fewer than 10,000 working loops, maximum allowable corporate operations expense per loop for each month equals $ 27.12 - 0.002 x (number of working loops);

- for companies with working loops greater than or equal to 10,000 loops, maximum allowable corporate operations expense per loop for each month equals $7.12.[3]

Correcting for Nonmonotonic Behavior in Model's Total Corporate Operations Expenses

5. The spline model has one undesirable feature. For a certain range, it yields a total allowable corporate operations cost that declines as the number of working loops increases. This occurs because multiplying the linear function that defines the first line segment of the estimated spline model (27.12 - 0.002 x the number of loops) by the number of loops defines a quadratic function that determines total allowable corporate operations expense. This quadratic function assumes its maximum value at 6,780 loops, well below the selected knot point of 10,000.[4] To correct this problem, we refined the formula defining allowable per loop expense to ensure that the total allowable corporate operations expense always increases as the number of loops increases. We chose a point to the left of the point at which the total corporate operations expense estimate peaks. At that selected point, the slope of the function defining total corporate operations expense is positive. We then calculated the slope at that point and extended a line with the same slope upward to the right of that point until the line intersected the original estimated total operations expense, which is represented by 7.12 x the number of loops.[5] Thus, we created a line segment with constant slope covering the region over which the original model of corporate operations expenses

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[2] *See* Figure 1.

[3] The R^2 associated with this regression is 0.396.

[4] The feature exists with all knot points considered. The practical effect of the function peaking at 6,780 loops is that a carrier with more than 6,780 loops, but less than 10,000 loops, will receive less corporate operations expense support than one with just 6,780 loops.

[5] *See* Figure 2.

declines so that total corporate operations expense continues to increase with the number of loops. We chose the point that leads to a line segment that yields the highest R^2.

6. Using this procedure, we selected 6000 as the point. The slope of total operations expense at this point is 3.12 and the line extended intersects the original total operations expense model at 17,988. Accordingly, the line segment formed for total corporate operations expenses, to be applied from 6000 loops to 17,988 loops, is \$72,024 + \$3.12 x the number of working loops. Dividing this number by the number of working loops defines the maximum allowable corporate operations expense per loop for the range from 6000 to 17,988 working loops, i.e., (\$72,024 ÷ (number of working loops)) + \$3.12.[6]

[6] *See* Figures 1 and 2.

Figure 1: Corporate Operations Expense per Loop

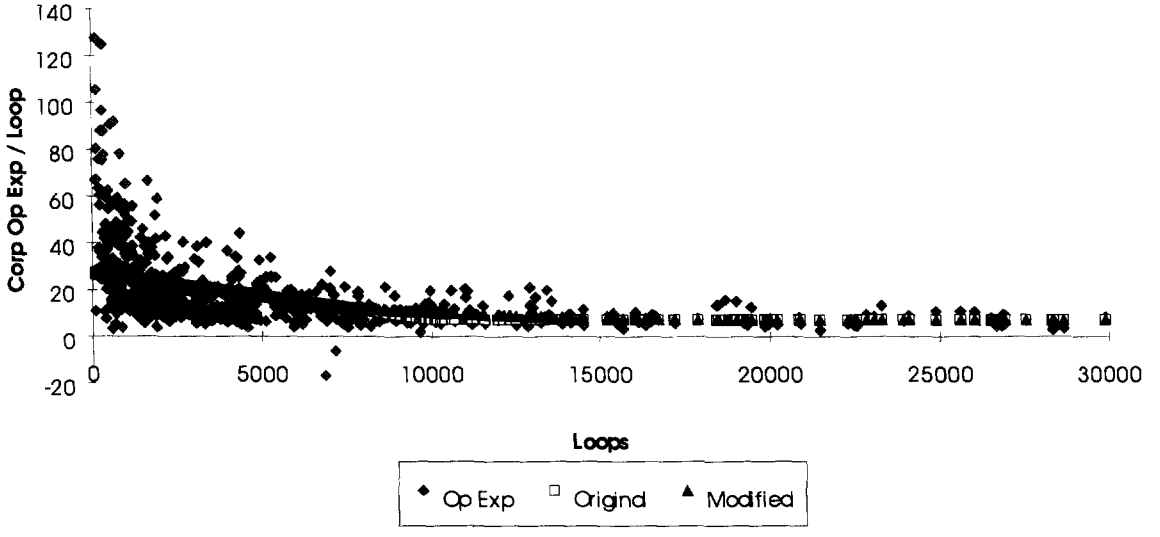

Figure 2: Total Corporate Operations Expenditure